

Ukrainian Housing and Communal Services Subsidy Program

Housing and Communal Services Subsidies

In Ukraine, targeted households that spend more than 20% (15% for some categories) of their income on housing and communal services are eligible for subsidies. This subsidy is a non-cash reduction in household payments for consumed housing and communal services, of which the largest share is for heating. This reduction is defined as the difference between the actual cost of the consumed services (within the standards set for their consumption), and the amount of mandatory utility payment (not exceeding 15 – 20% of the household's aggregate income). Local governments then pay service providers for the difference in billing. Please see attachment 1 for more detailed description.

Background

Several years after independence, in 1994, Ukraine had run up huge debts to Russia and Turkmenistan for oil and gas. The IMF and Ukraine reached an agreement through which Ukraine borrowed enough funds to keep Russia from turning off the energy supplies. Under the accord, Ukraine received a stand-by credit of up to \$1.7 billion, to be paid in four tranches, if Ukraine met a series of conditions. The Government of Ukraine promised price deregulation (including rapid increases in the prices for housing and communal services) as well as accelerated privatization, reduced deficits, monetary discipline, and other reforms. The Government scheduled a series of utility price hikes that would lead to monthly housing payments that would cover 80 percent of cost within less than one year. However, when monthly payments reached 20 percent of costs, a number of socialist and communist deputies from the Verkhovna Rada called on the population not to pay the increases. Many households were unable to pay their housing and communal services bills, as they reached 60 percent or more of these household incomes. Many pensioners, disabled people, and single mothers could barely buy enough food, even at subsidized prices. The Cabinet of Ministers hastily abolished all penalties on paying late, and thus arrears soared.

To address the massive arrears caused by non-payment, the GOU introduced a Housing Subsidy Program (HSP) in 1995. This targeted subsidy program allowed Ukraine to reach its 80 percent cost recovery in August 1996 versus the target date of September 1995.

Ukrainian Housing and Communal Services Subsidy Program 1995-2000

Ukraine used the proceeds of the first tranche of the IMF loan to pay Russia to ensure adequate fuel for the winter. However, this did not resolve its deepening financial and economic problems. With the IMF ensuring its loan conditions were followed, First Vice Prime Minister V. M. Pynzenyk asked USAID to help design a project to assist low-income families and to ensure that the housing sector price reforms continued. In January 1995, USAID began providing this help. The goal of the new project was to develop a means-tested social assistance program – the first in Ukraine -- for poor families to protect them from the full impacts of rising monthly payments for housing and utilities services.

In February 1995, a new Cabinet Decree created a housing subsidy program to assist low-income families. In May, 750 HSP offices were opened throughout Ukraine to receive applications from families. The housing subsidy was not in cash, but was rather a discount of monthly payments equal to the difference between 15% (later – 20%) of income and actual costs, based upon standardized apartment floor space per family size and other conditions). Housing maintenance organizations and utilities were to be paid this subsidy directly by local governments. Both qualified renters and homeowners were eligible. Qualified rural families facing annual payments for liquid gas and solid fuel for heating in excess of 20% of annual family income could also apply.

Before the HSP offices opened, the USAID project had designed, printed, and distributed more than a million copies of the six standard forms needed by local offices. The first subsidies were granted within a few days of the opening of the HSP offices. By the end of 1996, approximately 4 million of Ukraine's 17.1 million families were receiving assistance to help pay monthly utility payments or to assist in purchasing annual heating fuel supplies.

During the following months, the number of families receiving assistance slowly declined, as incomes reported by applicants grew (despite the absence of measurable economic recovery). By December 1997, the average household subsidy was about 30 Hrn/month. For single pensioners, the average housing subsidy was equivalent to an increase of pension benefits of 65%.

During 1997 through 2000 the main factors that influenced the housing subsidy program included price and tariff increases for housing and communal services, modifications to the procedure for granting subsidies, recalculation of subsidies by volume of actual service consumption, and better data control.

For the purpose of strengthening control over the accuracy of data on income submitted in application for a subsidy, in December 1997, the GOU initiated an audit of the Housing Subsidy Program. The approved procedure stipulated that overpaid amounts of subsidies would be recovered double the amount both from individuals who deliberately submitted false data and from legal entities that issued certificates containing false information. In these cases, individuals were deprived of the right for a repeated subsidy.

In July 1998, the Cabinet of Ministers introduced a mandatory ceiling increase from 15% to 20% of household payments for housing and communal services (except for pensioners and other disabled individuals). No household was required to pay more than 20% of its annual income on housing and communal services.

In early 2000 targeting of housing subsidies improved by considering the property status of a household when determining subsidy eligibility. Subsidies would not be granted, if a household: 1) rented out living premises; in the case of a purchased living premise the subsidy can be granted not earlier than a year after the purchase month; 2) was in possession of more than one living premise or a house with a floor area that exceeds the established standards; 3) was in possession of a vehicle that has been operated less than ten years as of the manufacture date (excluding granted or purchased vehicles on privileged conditions through agencies of labor and social protection for the population). Later in 2000, the "discount" subsidies for fuel and liquefied natural gas purchases were replaced by cash payments to recipient families.

Program Accomplishments

By implementing the targeted Housing Subsidy Program, Ukraine became the first country in the former Soviet Union to increase tariffs for housing and communal services. The Government was able to increase the level of utility payments from 4% in late 1994 to nearly 90% in 1999. As a result, in 1999 Government savings, after subsidy payments, totaled 2.4 billion Hrn. (or \$1.3 billion). Despite predications that practically all households in Ukraine would apply for subsidies, and program implementation costs would exceed savings from increased tariffs, the actual number of households participating in the housing subsidy program in 1997 through 2000 did not exceed 20-23 percent of the total number of Ukrainian households.

Current Status

The system of housing and communal services subsidies has not changed much since it was introduced in 1995 - 96. Today the key regulatory document defining the housing subsidy program is "Provision/Procedure about/on Granting and Providing Subsidies for Compensating Utility Expenditures, as well as Liquefied Gas, Solid and Liquid Domestic Fuels Expenditures." This was initially approved by the Cabinet of Ministers in October 1995 and was edited and amended in September 1997. The number of households applying for subsidies has been declining since 2000, because household incomes have been growing faster than tariffs for communal services. However, after tariff increases in the second half of 2006, the number of applications began to grow again. The GOU has been continuously trying to improve the housing subsidy system, ensuring better protection of low-income families, and streamlining the formal procedure for obtaining a subsidy. During the past decade, over a hundred amendments and additions have been introduced into the regulatory documents defining subsidies provision to the population. Some of the most important and most recent changes to the program introduced by the Cabinet of Ministers include Resolution #1703 (December 2003) "About Simplifying the Provision/Procedure about/on Providing..." and #310 (January 2007) "About Amending the Cabinet of Ministers Resolution #1156 (July 1996.*)" Through these amendments, the GOU has attempted to streamline the complicated procedures for subsidies provision.

In addition, the Program of Housing Subsidies has become more flexible and allows for some energy-saving incentives; low income families now can reduce their mandatory utility payments, if they reduce their level of consumption. Specifically, a household's utility payments will be reduced by 2% for every 10% savings in consumption.

Importance of Targeted Social Safety Nets

Additional reforms in the communal services sector, as well as ever-increasing natural gas prices, will exacerbate affordability problems, particularly among vulnerable low-income households. Deeper reforms

are necessary to establish commercial viability of heating enterprises and to stimulate energy efficiency. However, concerns over affordability make it politically difficult to enact reforms. The current social safety net system – the housing and communal services subsidy program -- lacks precision in targeting low-income households, and municipalities lack incentive to make the system more efficient. All too often, heating and utility subsidies create unfunded mandates for municipal heating and electricity companies. As municipal heating cannot be cut off, losses are covered by cross-subsidies out of business account payments, thus preventing investment and maintenance and further leading to a decline in the heating services.

Recommendations:

The recommendations below are based on the Municipal Heating Sector Assessment conducted by USAID in March 2007. However, there are other factors that should be studied and considered. For example, in addition to a means-based system of housing subsidies, Ukraine has a broad system of privileges. Certain classifications of the population and/or professional groups, such as war veterans or Chernobyl victims, benefit from discounted (“privileged”) tariffs for communal services. Contrary to targeted social subsidies, such privileges are not means-based. The system of privileges overlaps with the system of targeted subsidies sometimes substituting it and making it less effective. Privileges and subsidies are approved in the annual state budget as a single line-item. The share of privileges grows every year, while the share of subsidies declines. For more detailed recommendations, more research and analysis are needed.

- Social safety net utility payments should be means-based and better targeted. The current system lacks precision. Well-to-do households are not rare among housing subsidy applicants and beneficiaries. The system of privileges should be reformed.
- Payments should be made directly to recipients rather than to utilities, thereby giving recipients incentive to reduce consumption (as opposed to the current system, which sometimes encourages *increased* consumption).
- The Ministry of Labor and Social Protection should be informed about previous experiences showing that energy efficiency upgrades can reduce heating bills by a similar amount as the subsidy payments, at lower lifetime costs. The Ministry should be encouraged to emphasize household energy efficiency in addition to its targeted subsidies program.